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Supr. Ct. F...

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No. _____

In The
Supreme Court of the United States

NU-LOOK DESIGN, INC., and
JOSEPH M. GREY PUBLIC ACCOUNTANT, P.C., and
MIKE J. GRAHAM TRUCKING, INC., and
WATER-PURE SYSTEMS, INC., and
SUPERIOR PROSIDE, INC., and
SPECIALTY TRANSPORT & DELIVERY SERVICES, INC.,

Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Did the Third Circuit Court of Appeals commit reversible error in affirming Tax Court decisions which determined that an individual corporate officer, being also a sole or majority S corporation shareholder and worker in the S corporation, is an employee of the corporation under a narrow and out of context interpretation of 26 U.S.C. Sec. 3121(d)(1) without regard to applying the usual common law rules applicable in determining the employer-employee relationship mentioned in Sec. 3121(d)(2) and without regard to the Sec. 3121(d) paragraph following Sec. 3121(d)(3) which describes the non-employee status of an individual having a "substantial investment in facilities"?

2. Does a corporate taxpayer have a prima facie reasonable basis for not treating its sole officer (and sole or majority shareholder) as an employee pursuant to the provisions of Section 530 of the Revenue Act of 1978 by applying the "employment status" definition to the fact that each corporate petitioner never did nor never could exercice any control over its officer/owner; wherein said definition is contained in Section 530(c)(2) of the Act?

CORPORATE DISCLOSURE STATEMENT

The Petitioners, NU-LOOK DESIGN, INC., JOSEPH M. GREY PUBLIC ACCOUNTANT, P.C., WATER-PURE SYSTEMS, INC., MIKE J. GRAHAM TRUCKING, INC., SUPERIOR PROSIDE, INC. and SPECIALTY TRANSPORT & DELIVERY SERVICES, INC., are all corporations, incorporated in Pennsylvania.

Each of the above-named Petitioners is a nongovernmental corporate party to the proceedings and was a party to both the proceedings in the United States Tax Court ("Petitioner") and the U.S. Court of Appeals for the Third Circuit ("Appellant").

Each of the above-named Petitioners does not now have nor has ever had any parent or subsidiary corporation, and each of the above-named Petitioners is not now nor has ever been the parent or subsidiary corporation of another corporation.

No publicly held corporation nor any other corporation owns or ever has owned ten percent (10%) or more of the stock of any of the above-named Petitioners.

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The six Petitioners, Nu-Look Design, Inc. ("Nu-Look"), Joseph M. Grey Public Accountant, P.C. ("Grey, P.C."), Mike J. Graham Trucking, Inc. ("Graham Trucking"), Water-Pure Systems, Inc. ("Water-Pure"), Superior Proside, Inc. ("Superior"), and Specialty Transport & Delivery Services, Inc. ("Specialty"), have been grouped in this petition for the convenience and preference of this Court, since they involve the same questions of law arising from a challenge of the Internal Revenue Service's ("I.R.S.") classification of a sole officer/shareholder (owner) of an S corporation into an employee of the corporation; they, therefore, come before this Court to request that a writ of certiorari issue to review the judgments and opinions of the United States Court of Appeals for the Third Circuit ("Third Circuit") which affirmed the opinions and decisions of the United States Tax Court ("Tax Court").

OPINIONS BELOW

The Tax Court's opinion in each of Nu-Look, Grey, P.C., Graham Trucking, Water-Pure, Superior, and Specialty are reproduced on pp. 12a-A, 43a-B, 63a-C, 82a-D, 108a-E, and 136a-F, respectively, in the separately bound Appendix.

The Third Circuit's opinion in each of Nu-Look, Grey, P.C., Graham Trucking, Water-Pure, Superior, and specialty are also reproduced in the Appendix pp. 1a-A, 36a-BCD, 36a-BCD, 36a-BCD (3 appellants combined), 102a-E, and 128a-F, respectively, which were filed by the Third Circuit on January 26, 2004, April 7, 2004, April 7, 2004, April 7, 2004 (3 appellants combined), January 28, 2004, and March 12, 2004, respectively. The Nu-Look opinion rendered by the Third Circuit was the only published precedential one of the six. The other five opinions of the Third Circuit were unpublished "not precedential opinions."

JURISDICTION

The Third Circuit's order denying Nu-Look's petition for rehearing en banc was entered on April 1, 2004 (see Appendix p. 35a-A). The Third Circuit's judgment affirming the Tax Court's decisions in Grey, P.C., Graham Trucking, and Water-Pure (3 appellants combined) was entered April 7, 2004 (see Appendix p. 42a-BCD). The Third Circuit's order denying Superior's petition for rehearing en banc was March 29, 2004 (see Appendix p. 127a-E). The Third Circuit's judgment order affirming the Tax Court's decision in Specialty was "issued in lieu of a formal mandate on May 13, 2004" (see Appendix p. 135a-F).

Jurisdiction is conferred on this Court under 28 U.S.C. Sec. 1254(1).

RELEVANT PROVISIONS INVOLVED IN CASE

I. Statutes:

A. 26 U.S.C. Sec. 1366(b) (App. p. 159a)
B. 26 U.S.C. Sec. 3121(d) (App. p. 159a)
C. Section 530 of the Revenue Act of 1978, as amended (App. pp. 160a to 162a)

II. Other Authorities:

A. "Explanation of Provisions" portion of H.R. Rep. No. 95-1748, 95th Cong., 2d Ses. 5 (1978) 1978-3 (Vol. 1) B.B. 631 - 633 (App. 163a & 164a)

B. Definition of "or" as found in Webster's Third International Dictionary of the English Language Unabridged, p. 1585 (1993 Ed.) (App. p. 164a)

C. Federal Labor regulation defining "employees" as found in 29 C.F.R. Sec. 2510.3-3(c)(1) (App. p. 164a)

STATEMENT OF THE CASE

Each petitioner in this case was incorporated under the laws of the Commonwealth of Pennsylvania and were approved by the I.R.S. as subchapter S corporattions (S corp.) subject to the pass-through provisions of 26 U.S.C. Sec. 1366. Each petitioner in this petition received a "Notice of Determination Concerning Worker Classification Under Section 7436 ("Notice of Determination") from the I.R.S. advising that, in the case of Nu-Look, that Ronald A. Stark was an employee of Nu-Look during 1996, 1997, and 1998; in the case of Grey, P.C., that Joseph M. Grey was Grey' P.C.'s employee during 1995 and 1996; in the case of Graham Trucking, that Michael J. Graham was Graham Trucking's employee during 1995, 1996, and 1997; in the case of Water-Pure, that Martin L. Ridge was Water-Pure's employee during 1996, 1997, and 1998; in the case of Superior, that Thomas L. Murdock was Superior's employee during 1995, 1996, and 1997; in the case of Specialty, that John F. Ludlow was Specialty's employee during 1996, 1997, and 1998. Each Notice of Determination sent to each Petitioner herein further stated that each one was not entitled to relief from said employer classification of the above-named individuals as being reclassified as an employee of the respective S corp..

At all times since the incorporation of each Petitioner in this petition was solely owned by either one shareholder (Nu-Look's sole shareholder/officer: Ronald A. Stark; Grey, P.C.'s sole shareholder/officer: Joseph M. Grey; Superior's sole shareholder/officer: Thomas L. Murdock; and Specialty's sole shareholder/officer: John F. Ludlow) or one-hundred percent (100%) family owned shareholders (Graham Trucking: Michael J. Graham: sixty percent (60%) shareholder, Reva G. Graham, Mr. Graham's daughter: fifteen percent (15%) shareholder, and Bethann Graham, Mr.

Graham's daughter: 25% shareholder; Water-Pure: Martin L. Ridge: 50% shareholder and Jean S. Ridge, Mr. Ridge's wife: 50% shareholder) including the years at issue in each of the Notices of Determination sent to each Petitioner by the I.R.S..

After receiving each Notice of Determination, each herein-named Petitioner challenged the said Notice by timely filing a petition in the United States Tax Court, the court of first jurisdiction under Title 26 U.S.C. Sec. 7436(a), in which each Tax Court petition pled that each of the named S corp. shareholders was not an employee of his respective S corp. under the proper application of the usual common law rules of the employer-employee relationship tests of control and later pled on the Tax Court record in each case, that each petitioner was entitled to relief from employment status classification under the provisions of Section 530 of the Revenue Act of 1978, as amended. The common law definition of an employee was rejected by both the Tax Court and the Third Circuit in each case on appeal from the Tax Court in determining that a corporate officer is an employee of the corporation because he "performed more than minor services" on behalf of the corporation, since each said shareholder/officer was substantially the only individual who worked in each S corp.; even though each said shareholder/officer was never under the control of his respective S corp. in the performance of his work on behalf of the respective S corp..

The record reproduced in the separately bound Appendix in this petition clearly shows that each Petitioner never treated any shareholder/officer as its employee for any period at issue or during any other period in its existence as an S corp. under the reasonable belief that no employment status ever existed between them under the

application of the common law tests of control in determining any employer-employee relationship which was a reasonable basis for the non-employee treatment of the individuals wrongly classified as employees by the I.R.S. which is the subject matter of this petition.

REASONS FOR GRANTING THE WRIT

I. National impact on small business owners as a result of the lower courts' judgment in the subject matter of this petition.

As a result of the Tax Court's and Third Circuit's opinions and judgments in this case, hundreds of thousands of small business owners choosing the S corporation form and who do not hire any employee will be forced to pay employment taxes on non-existent employees, themselves, where no common law employment exists. The wrongful I.R.S. classification of S corp. business owners will and has created serious financial hardship on these business owners so classified which is also detrimental to the National economy.

II. The Third Circuit's decision in its denial of application of common-law employer-employee relationship with respect to corporate officers conflicts with decisions of this Court and other Circuits.

This Court ruled in **Clackamas Gastroenterology Associates, P.C. v. Wells**, 271 F.3d 903 (9th Cir. 2001), **rev. and rem.** 123 S.Ct. 1673 (2003), that

> "The common law element of control is the principal guidepost to be followed in deciding whether the four director-shareholder physicians in this case should be counted as employees. The mere fact that a person has a particular

> title — such as partner, director or vice president [a corporate officer's title] — should not necessarily be used to determine whether he or she is an employee..."("an individual's title...does not determine whether the individual is a partner, officer, member of a board of directors, or a major shareholder, as opposed to an employee.")." 123 S.Ct. at 1673, 1680.

Wells, 123 S.Ct. at 1680, followed its precedent in this Court's instructions on the application of common law agency in **Nationwide Mut. Ins. Co. v. Darden**, 503 U.S. 318, 112 S.Ct. 1344, 117 L.Ed. 581 (1992). **Darden** was an ERISA case, and Federal labor regultaion 29 C.F.R. Sec. 2510.3-3(c)(1) (see Appendix p. 164a) exempts a sole owner or a husband and wife jointly totally owned business (incorporated or unincorporated) from being classified as employees of the respective business in that regulation's definition of "employees." This is exactly the same situation here, since each Petitioner is either composed of a sole shareholder or spousal shareholders.

The First Circuit ruled that a corporate officer is only an employee within the meaning of the Social Security Act when a real agency common law employer-employee relationship occurs, and such a corporate officer is not an employee if no such common law relationship exists between the corporation and the individual, despite the fact such individual is a corporate officer. See **United States v. Griswold**, 124 F.2d 599, 602 (1st Cir. 1941), and **Deecy Products Co. v. Welch**, 124 F.2d 592 (1st Cir. 1941). The Second Circuit also agreed with **Griswold** in **Texas Co. v. Higgins**, 118 F.2d 636, 637 (2nd Cir. 1941) which was cited in **Griswold** at 124 F.2d at 601.

This Court's **Skidmore v. Swift & Co.**, 323 U.S. 134, 140 (1944), further demonstrates the

proper focus on employment status inquiries must be "the common-law touchstone of control."

The Third Circuit used **Spicer Accounting, Inc. v. United States**, 918 F.2d 90, 93 (9th Cir. 1990), to abrogate and reject the common law in determining that Mr. Spicer, the sole shareholder of his S corporation, was an employee because he worked and not because he was or even could be **controlled** by Spicer Accounting, Inc.. The same Ninth Circuit later refuted its **Spicer** analysis in **Idaho Ambucare Center, Inc. v. U.S.**, 57 F.3d 752 (9th Cir. 1990), which stated:

> "We are not convinced that Spicer forecloses the application of a dual capacity analysis. Having concluded that Mr. Spicer performed substantial services, the Spicer Court went on to analyze Spicer's status under common law rules, implicitly suggesting that if Mr. Spicer were an independent contractor under such rules, he would not be considered a corporae employee, despite his role as a corporate officer performing substantial services." (**Idaho**, 57 F.3d at 752).

The **Spicer** court cited Revenue Ruling 82-83, 1982-1 C.B. 151, which distinguished services performed by the corporate officer in the role of a non-officer. In the instant petition, each shareholder performed mostly non-officer like services for his respective S corp., as the record clearly shows.

The Eleventh Circuit ruled that a corporate director was not an employee within the officer provisions of 26 U.S.C. Sec. 3121(d)(1), since no one had the power to control the duties of his work as a director. See **Steffens v. Commissioner**, 707 F.2d 478 (11th Cir. 1983).

III. The Third Circuit's erroneous argument that "or" is disjunctive in 26 U.S.C. Sec. 3121(d)(1) in order to justify the abrogation of the common law employer-employee relationship mentioned in Sec. 3121(d)(2) is a preposterous contrivance and a flagrant miscarriage of justice.

Webster's unabridged dictionary defines "or" as the "synonymous, equivalent or substitutive character of two words or phrases..." and "...correction or greater exactness of phrasing or meaning." See Appendix p. 164a. Therefore, the Third Circuit's bizarre notion that "or" in Sec. 3121(d)(1) is disjunctive, thereby making the common law rules mentioned in Sec. 3121(d)(2) inapplicable to corporate officers in determining whether they are employees, is a meritless and outrageously ridiculous argument.

The term "or," as used throughout Sec. 3121(d) is simply used to further clarify the character of "any individual" in Sec. 3121(d)(2) who is also "any officer," since a corporate officer is also an individual. Any other rendering of subparagraphs (1) and (2) in sec. 3121(d) is preposterous and should be reversed by this Court, i.e., the absurd rendering of "or" in this case by the Third Circuit.

IV. A corporate officer is not an employee if he has a substantial investment in facilities used in connection with the performance of services described in the paragraph immediately following 26 U.S.C. Sec. 3121(d)(3).

Title 26 U.S.C. Sec. 3121(d) is reproduced in relevant part on p. 159a of the Appendix which contains a paragraph which provides that an

individual (including a corporate officer) is not an employee if such individual has a "substantial investment in facilities used in connection with the performance" of services. This is the case here, since each mentioned corporate officer-shareholder has more than a substantial investment in the facilities used in connection with the services each one performs for his S corp., since he owns **all** of the stock of his respective S corp. either solely or with his wife; except in the case of Graham Trucking, in which Mr. Graham's daughter, Bethann Graham, owned 25% of the corporate stock, and Mr. and Mrs. Graham owned the remaining 75% of the corporate stock in Mike J. Graham Trucking, Inc.. Ownership of a business is a key factor in determining that the owner and/or owners are not employees of the business. See 29 C.F.R. Sec. 2510.3-3(c)(1), reproduced on p. 164a of the Appendix. This is the reason for the inclusion of the "substantial investment in facilities" phrase in Sec. 3121(d), making it part of a statute.

V. The Third Circuit's reliance on Treasury Regulations to reject the common-law control in an employment status controversy involving corporate officers was improper.

Treasury Regulations 31.3121(d)-1(b) and 31.3306(i)-1(e) are not statutes, since they were promulgated by the Dept. of the Treasury and the I.R.S.. They are not controlling, and Federal courts are not bound by them. Even if they were arguendo, their original intention was just the opposite of the Third Circuit's misuse of them. Those Treas. Regs. were originally promulgated to **prevent** non-working or only minimally working corporate officers from obtaining the status of employees. This made sense, since **Fleming v. Lindgren**, 275 F.2d 596 (9th Cir. 1960) addressed that problem by rejecting a corporate

officer's employee status based on a salary of $300 per month for six quarters to the "corporate president," stating that it was not sufficient for him to qualify for social security benefits. Lindgren was a chicken farmer whose lawyer found him an old corporate shell and put the chicken business into it. The only amount of corporate income left to pay was $745. The Ninth Circuit stated in **Lindgren**, that "[i]t would not be permissible for relatives to set up a corporation for six months, pay a ne'er-do-well a salary of $300 a month for six quarters and have him do absolutely nothing (if provable) from beginning to end, then shift the burden of his support to the government."

Treas. Regs. 31.3121(d)-1(b) and 31.3306(i)-1(e) are now being used by the I.R.S. and the lower courts (as law) to improperly inflict employment status on non-employee business owners, such as the shareholders of the present Petitioners.

VI. The definition of "employment Status" in Section 530(c)(2) of the Rev. Act of 1978 as applied to corporate officers provides a reasonable basis for not treating a corporate officer as an employee.

Section 530(c)(2) provides a **prima facie reasonable basis** for not treating any of the herein named corporate shareholder-officers as an employee, since corporate officers are not excluded from the application of the "employment status" definition in Sec. 530(c)(2) of the Rev. Act of 1978, reproduced on p. 160a of Appendix. The lower courts in this case used a narrow, exclusive, and out of context interpretation of Sec. 3121(d)(1) to improperly determine that Sec. 530(c)(2) does not apply to corporate officers. This error should be reversed by this Court.

VII. Congressional intent and various Revenue Rulings assert a liberal application of the "reasonable basis" requirement for not treating an individual as an employee in Sec. 530 of the Rev. Act of 1978, as amended.

Congress made its intention clear in H.R.Rep. No. 95-1748, 95th Cong., 2d ses. 5 (1978) 1978-3 (Vol. 1) C.B. 631-633, (Appendix p. 163a) which states that

> "The committee intends that this reasonable basis [mentioned in Sec. 530(a)(1)] requirement be construed liberally and in favor of taxpayers..." and "The three statutory methods [mentioned in Sec. 530(a)(2)] for fulfilling the requirement that a taxpayer had a reasonable basis for the treatment of an individual as other than an employee are not the exclusive ways of meeting the bill's reasonable basis requirement. A taxpayer who can demonstrate a reasonable basis for the treatment of an individual in some other manner also is entitled to termination of employment tax liabilities..."

The I.R.S.'s Revenue Procedure 85-18, I.R.B. 1985-13, 27, also reiterated the elements in H.R.Rep. No. 95-1748, supra, and went on to state that, "for purposes of section 530(a) of the Act [Revenue Act of 1978], the term employee means employees under sections 3121(d), 3306(i) and 3401(C) of the Code." This means that corporate officers are included under the provisions of safe harbor relief from employment status pursuant to Sec. 530 of the Rev. Act of 1978.

Rev. Rul. 58-505, 1958-2 C.B. 728 and Rev. Rul. 82-83, 1982-1 C.B. 151 also give guidance in

connection with the treatment of corporate officers as other than employees, based on the character of services they perform and not on the amount of work they do in non-officer type work, such as the type of work done by the shareholder-officers in this case, i.e., non-officer services in the business of each S corp. Petitioner. This concept is similar to the **Idaho Ambucare** analysis without regard to the amount of services performed by the corporate officer. Therefore, the Third Circuit should be reversed, since it improperly relied on the amount of work done by each corporate officer, as opposed to each officer-shareholder's non-employee and independent contractor type services out of the control of the respective corporation. In sum, the common law in employment status inquiries is always the "guidepost" and the "touchstone" in determining the existence of an employee.

The Third Circuit's abrogation and rejection of the common law rules in determining the employer-employee relationship constituted a flagrant miscarriage of justice and cries out for correction.

CONCLUSION

For these various reasons, this petition for certiorari should be granted.

Respectfully submitted,

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Date: June 25, 2004